

Assessing the Sponsor Covenant

The Institute of Actuaries
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Background

- Schemes in deficit

longevity
equity returns
interest rates
- Deficits are unsecured loans to sponsor

scheme

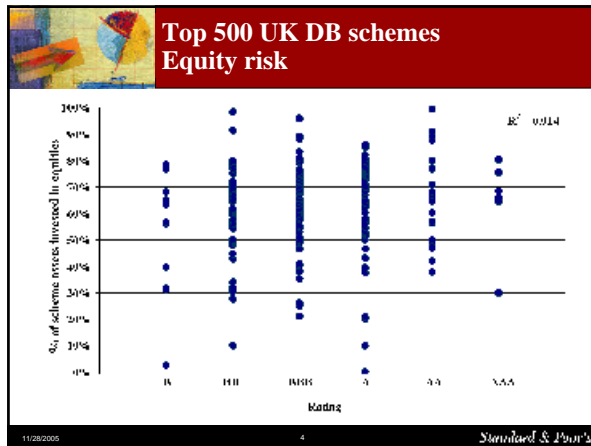
sponsor
- Schemes are exposed to default risk

Trustees need to be confident sponsor can fulfil its obligations

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Standard & Poor's

Top 500 UK DB schemes FRS 17 underfunding

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What are credit ratings ?

The most commonly used measure of a company's financial strength

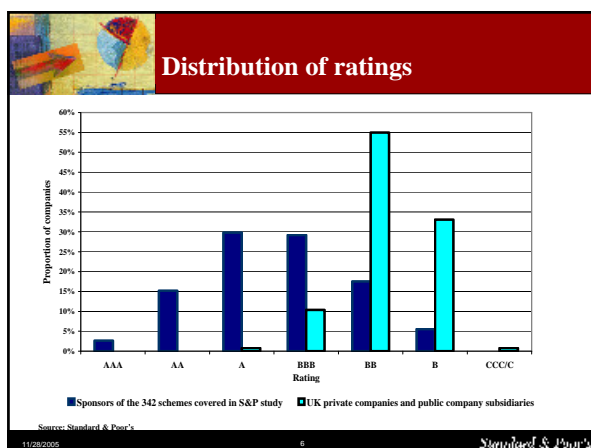
Coverage

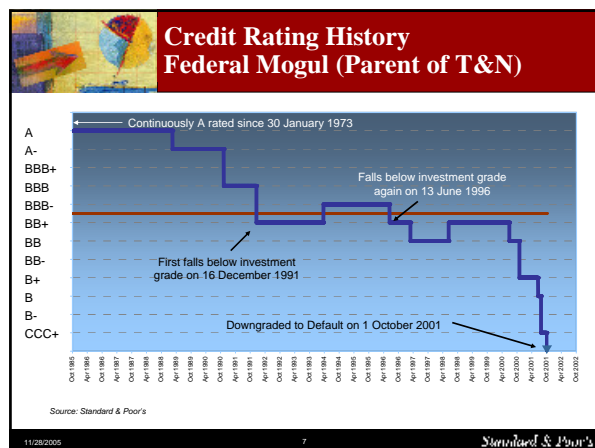
- Interactive ratings (266) mostly listed companies
- Quantitative assessments (350,000) listed, private, subsidiary companies

Credit assessments are available for virtually all UK defined benefit scheme sponsors

low risk	investment grade
AAA	
AA	
A	
BBB	speculative grade
BB	
B	
CCC	
high risk	

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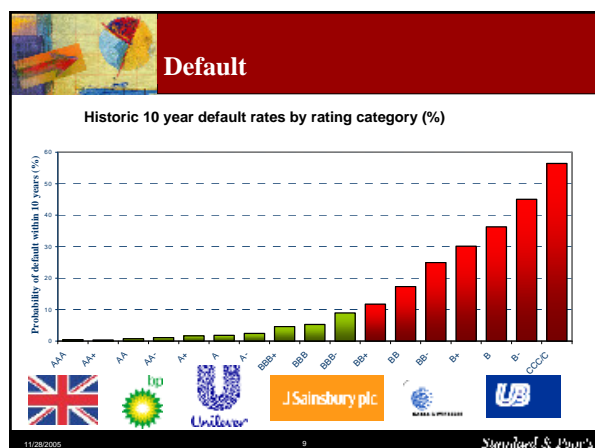
Default

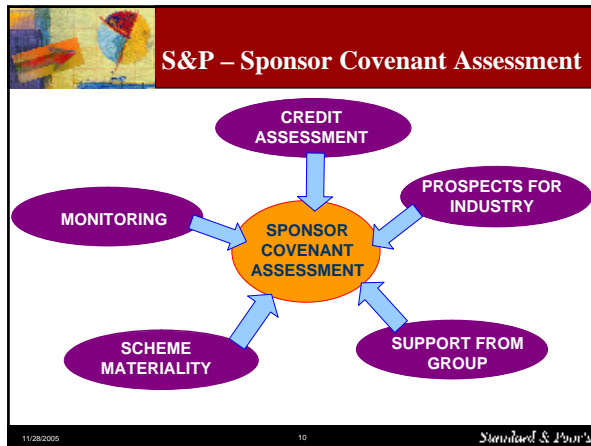
- Credit strength needs to be placed in context
- Default data shows risk of recovery period

Cumulative Default Rates (Percentages)

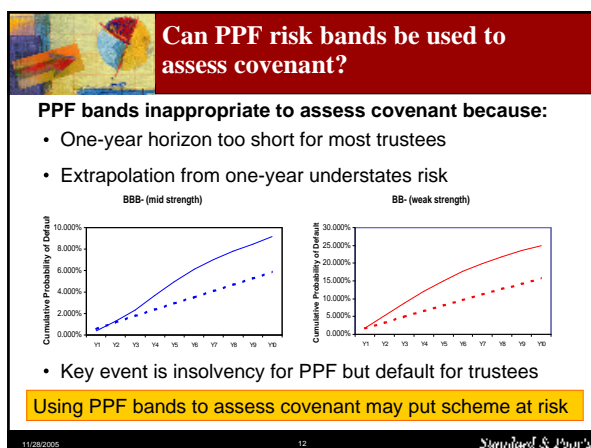
Rating	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Y11	Y12
AAA	0.00	0.00	0.03	0.06	0.10	0.17	0.24	0.36	0.41	0.45	0.45	0.45
AA	0.00	0.00	0.00	0.07	0.15	0.23	0.35	0.50	0.63	0.77	0.88	0.96
A	0.04	0.12	0.17	0.25	0.42	0.65	0.87	1.13	1.41	1.80	2.12	2.29
BBB	0.28	0.62	0.91	1.52	2.17	2.76	3.31	4.01	4.58	5.27	6.04	6.52
BB	0.95	2.99	5.47	7.78	9.98	12.19	13.84	15.31	16.51	17.34	18.26	18.99
B	8.34	16.68	22.60	26.60	29.44	31.88	33.36	34.44	35.40	36.29	37.27	38.32
CCC/C	28.83	37.97	43.52	47.44	50.85	52.13	53.39	54.05	55.56	56.45	57.20	57.99


Data Source: Standard & Poor's Risk Solutions
Application: CreditPro® 7.0
Calculation Type: Conditional on Survival











SCA

Summary of benefits to trustees

- ▶ **Independent** opinion of sponsor covenant
- ▶ Placed in context - can be incorporated into funding plans
- ▶ Compliance with TPR's codes of practice
- ▶ Considers broader picture – industry prospects, materiality
- ▶ 12 month assessment – not 'point in time'
- ▶ Cost effective - **£6,000 to £10,000** (depending on complexity)

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